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To be argued by

IRVING MARIASH.

Supreme Court of the United States

OCTOBER TERM, 1936

FRANCIS I. DUPONT, EDMUND DUPONT, RHETT DUPONT, E. PAUL DUPONT, WILLIAM A. FINE, ARTHUR F. SHETTLE and WILLIAM A. WHITAKER, co-partners, trading under the firm name and style of FRANCIS I. DUPONT & COMPANY, Plaintiffs-Appellants, against UNITED STATES OF AMERICA, Defendant-Respondent.	No. 332

BRIEF FOR PLAINTIFFS-APPELLANTS.

Appeal from a judgment of the Circuit Court of Appeals for the Second Circuit, affirming a judgment of the United States District Court, Southern District of New York, rendered by Judge Goddard. The action is for a refund of taxes. Cross-motions for summary judgment were decided in favor of the defendant, and the complaint was dismissed.

Opinions of the Courts Below.

The opinion of the District Court, though not reported, is in full in the record (R. 24). The opinion of the Circuit Court (R. 31) is reported at 83 F. (2d) 951.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 8, 1936 (R. 34). The petition for a writ of certiorari was granted October 19, 1936. The jurisdiction of this Court is invoked under the provisions of Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Where a customer transfers his account from one broker to another, is the transfer taxed as a "sale" under Revenue Act of 1926, Title 8, Section 800, Schedule A-4 (26 U. S. C. A. 900, 903), merely because the parties used printed sheets designated "bought" and "sold"?

2. Does the exclusive fact that certain printed forms were used, alone determine the taxable status, without any relation whatsoever to the legislative intent to tax well-defined transactions (sales) through the instrumentality of documents used in carrying them out?

3. Which of the two diametrically contradictory constructions of the statute here involved is correct: *United States v. Uhlmann Grain Co.*, 84 F. (2d) 901, holding no tax due, or the case at bar, holding the tax to be due?

Statement of Facts.

The facts are undisputed, both petitioners and respondent relying on the affidavits of the same persons. They are correctly outlined in the opinion of the District Court (R. 24). They are not correctly set forth in the opinion of the Circuit Court, as shown hereafter. The review of the facts in the latter opinion is not supported by the record.

Petitioners are brokers on the New York Cotton Exchange. A customer, J. P. Abney, and his associates, purchased 24,100 bales of cotton futures contracts. He carried them with petitioners' brokerage house, that is, he was "long" that number of bales. At the request of the brokers, the customer transferred his account to another broker, Messrs. Fenner & Beane (R. 9-10). *The contracts still remained in the name*

of the same customer and were still owned by the same customer before and after the transfer from the brokerage house of DuPont to the brokerage house of Fenner & Beane (R. 8-9).

The Cotton Exchange uses only one set of forms for convenience (R. 9-11). Whether an actual sale takes place or whether there is merely a transfer of an account from one broker to another, the transaction is cleared by reporting it on "sold" sheets from DuPont and "bought" sheets from *Fenner & Beane.* These same documents, therefore, in some instances are evidence of a sale and in some instances are merely evidence of a transfer of brokers (R. 11).

The Secretary of the Clearing Association testified: "While the transaction referred to was reported on 'Sold by' and 'Bought by' sheets, *that by no means shows that it was necessarily a sale.* Every transaction, whether a sale or not, between brokers must be reported on these sheets as they are the only forms we use. Every purchase and sale of cotton for future delivery is recorded on these forms. But, also, every transfer from broker to broker *without involving a sale* is recorded on the same forms" (R. 11). This was corroborated by all the witnesses (R. 7 to 11).

The Secretary of the Cotton Exchange testified: "Although it appears from the signing of purchase and sale contract slips and the filing of the tax return sheets that an additional purchase and sale had been made, such is not the case. It is simply a transfer of outstanding contracts, from the carrying to the receiving broker, and the customer is not penalized by the payment of a commission or revenue tax. *If an actual change of ownership took place, the house carrying the contracts would not be permitted to waive its commission.* The inclusion of the transaction on the sales and purchase slips is merely for the purpose of preserving the regularity of our records" (R. 10).

"Both the house carrying the contracts and the house receiving the outstanding contracts are required to sign the regular purchase and sales slips so that their respective positions with the Clearing House may be correctly stated as regards the transfer" (R. 11).

Although in fact there was no real sale involved, but merely the transfer of Abney's account from DuPont to Fenner & Beane, at the end of the month DuPont's stamp clerk, erroneously, and as a matter of routine, affixed stamp taxes on the monthly reports to cover this transaction.

The good faith of the parties is conceded by the Government, and in fact a tax was ultimately paid when the cotton contracts were really sold by Abney (R. 9). The denial of the refund results in two taxes having been paid, although the cotton was sold only once.

Specification of Errors.

The Court below erred:

1. In holding that the transfer involved a contract of sale.

2. In holding that the petitioners were not released after the transfer and still remained obligated to receive delivery.

3. In rejecting the testimony of all of the witnesses as to the nature of the transaction as mere expressions of opinion.

4. In holding the transaction was not within the exception covering "transferred" sales.

5. In holding the transaction was taxable.

6. In affirming the judgment of the District Court.

ARGUMENT.

POINT I.

The transaction was not a sale in fact or by any usage.

That there was *no real sale* is readily seen from the following: (a) no title passed, but at all times remained in the one owner, Abney; (b) no consideration or price was paid; (c) there was no buyer or seller, merely brokers for one principal.

That the transaction was not a sale under the usages of the Exchange is evidenced by: (a) the testimony of the Secretaries of both the Exchange (R. 10) and the Clearing Association (R. 11); (a) by the rule of the Exchange that no commission can be charged on a transfer, whereas commission *must* be charged on sales under the usages of the Exchange; (c) by the fact that the usages require a sale to go through the "pit" or floor of the Exchange with opportunity for every broker on the floor to bid on it, whereas this did not go through the floor but was accomplished by an exchange of memoranda between the two brokers to the exclusion of other member-brokers; (d) that, under the Exchange usages, the price must be the current quotation, whereas this was transferred at the original cost to Abney.

The only bearing or similarity that this transaction has to a sale is solely the use of "bought" and "sold" memoranda, *which all parties agree is a false and inaccurate description of the true nature of the deal. The very means of identification used by the Government are the very ones which everyone agrees are erroneous.*

As to the contention that DuPont was seller and Fenner & Beane buyer, the record discloses the true principal, and only by blinding ourselves to the true state of facts can the fiction be indulged.

Contrary to the facts and contrary to the record, the Circuit Court of Appeals found that the transaction did not release DuPont, and that DuPont still remained obligated on the contracts transferred to Fenner & Beane. Nothing in the record supports this erroneous finding. The Circuit Court sweeps aside the uncontradicted statements in the record to the contrary by saying arbitrarily that they are "merely expressions of opinion by the affiants" (R. 33). The affiants happen to be the *only* persons, and *all* the persons, who know the true nature of the transaction. They include two experienced brokers and both the secretaries of the Exchange and the Clearing Association. Anyone conversant with commodity exchanges knows that on a transfer of contracts, the first broker is completely out of the picture. The Court apparently was thinking of a "hedge," but a "hedge"

is done on the open floor by *viva voce* bidding and all traders on the floor have an opportunity to bid on the purchase and sale. This transaction was a transfer which did not go on the open floor, was not a "hedge" and did not leave DuPont with remaining liability upon the contracts. It was the Circuit Court's complete misapprehension of this simple business process that apparently induced its erroneous conclusions.

POINT II.

Erroneous and misleading bookkeeping forms do not determine the nature of a transaction for tax purposes.

A. THE REASONING OF THIS DECISION THAT FORM ALONE CONTROLS HAS BEEN SQUARELY REFUTED IN A LATER OPINION IN THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT. *United States* v. *Uhlmann Grain Co.*, 84 F. (2d) 901, exactly parallels the case at bar. Brokers on the Board of Trade in Chicago transferred accounts from one to another, as did the brokers on the Cotton Exchange herein. As between the brokers, they understood that it was not a real sale, but simply a transfer of the accounts for purposes of their own. As far as the Board of Trade was involved, it was recorded as a sale, exactly as in the case at bar where the Cotton Exchange records apparently showed it to be a sale.

Likewise parallel, the transaction in that case did not go through the "pit" or floor of the Exchange, but was done as a private office transaction. The reason for this was the same in both cases. If it went through the "pit" or floor, every other broker might have bid on it and the price would have been the current price on the floor. Since they merely intended to transfer the accounts, they did so, not at the current price, but at the same price at which it was carried on their books. In both cases, had there been a *bona fide* sale, the Board of Trade and Cotton Exchange regulations would have absolutely required it to go on the floor, but since it was not a *bona fide* sale, a private transaction was

proper. In both cases, the records of the brokers show the true nature of the transaction, although the records of the Clearing Association and Board of Trade made it appear like a sale. The relationship of the parties, their respective rights and liabilities and the usages of the Exchange were parallel.

The decision in the case at bar was urged before the Court in the Seventh Circuit, but when it rendered its opinion the Court frankly disagreed with it. The arguments raised by the Government counsel, though the same as in the case at bar, were rejected by that Court. Likewise, the reasoning of the Circuit Court in the case at bar as to the assumption of liability by the brokers was held immaterial in that decision. The Court candidly recognized that the transaction was not the usual sale, was not put through on the floor of the Exchange, was brought about by an office communication rather than a trade, and that its correct nature was shown by the records of the brokers, although the official records of the Clearing Association made it appear like a sale.

After reviewing the facts the Court said:

> "There is a substantial difference between the records of an actual, completed sale which all parties agree is subject to the tax, and those of such a transaction as is here sought to be taxed, although both show up on the final records of the clearing house as sales. Appellant argues that because the transfer is recorded by the clearing house as a sale, with no indication on its records of its accommodation character, and because the Board of Trade will recognize such transfer only on the basis of the assumption by the accommodation party of liability to fulfill the contract in case of default by the accommodated one, it must be considered a sale, agreement of sale or agreement to sell, subject to the tax. It apparently considers immaterial the fact that the transaction was brought about by the irregular method of an office or telephone communication, rather than in the pit. It argues that the government should be able to tax transactions according to the official records of the clearing house without having to refer to private

> agreements which negative their effect, or having to inspect subordinate records in order to determine how the transaction took place."

The Court then having its attention called to the decision in the case at bar commented upon it as follows, after brushing aside immaterial distinctions on the facts:

> "The decision of the New York case does not, however, rest on this distinction. Instead, the court there emphasizes the form of the transaction, 'Although the purpose of the transaction was to transfer a customer's account from one brokerage firm to another, the mechanics of doing this involved a contract of sale for future delivery made by the plaintiffs with the substitute broker. * * *' *The same might be said as to the transaction here involved, if we chose to be governed by the mechanics rather than the purpose of the transfers. We think, however, that the character of the transaction is not conclusively determined by the nature of the bookkeeping entry used in bringing it about. We agree with the finding of the District Court that the transactions herein described were not sales, agreements of sale, or agreements to sell, hence were not properly taxed as such.*" (Italics ours.)

We respectfully urge that the realistic and practical approach of the Seventh Circuit Court, with full recognition of the actual facts, is much to be preferred to sustaining a tax upon a fiction, conceived in inaccurate bookkeeping, and given judicial recognition by refusing to see the true facts as they are undisputedly disclosed. Reasoning such as applied by the Court in the case at bar gives origin to the unhappy connotation attached to the words "legalistic reasoning." The tendency of modern judicial thought is not to unnecessarily differentiate the logic of the forum from the logic of the market place.

B. THE COURT DISREGARDED THE WELL-RECOGNIZED MAXIM THAT DOUBTS AS TO THE PROPRIETY OF THE TAX SHOULD BE RESOLVED IN FAVOR OF THE TAXPAYER. *United States* v. *Isham*,

17 Wall. 496 (1873), 21 L. Ed. 728, 84 U. S. 496, laid down the following cardinal principle:

> "If there is a doubt as to the liability of an instrument to taxation, the construction is in favor of the exemption."

The doubt on the construction of this taxing statute is so great that several District Court opinions conflict, and the Circuit Courts of Appeals in the Second and Seventh Circuits are in disagreement (see *United States* v. *Uhlmann*, *supra*).

The decision at bar is in conflict with *Union Trust Co.* v. *Heiner*, 26 F. (2d) 391; *Dean* v. *Caldwell*, 9 F. Supp. 177; *Field Glore* v. *United States*, (Standard Fed. Tax Service, Vol. 3-A, 1935, pp. 9803-9805); *A. B. Leach* v. *United States*, 84 F. (2d) 908; *National Bond & Share Corp.* v. *Hoey*, D. C., S. D. N. Y., November 6, 1935, and April 15, 1936; and *United States* v. *Uhlmann Grain Co.*, 84 F. (2d) 901.

The Circuit Court for the Second Circuit has expressly repudiated the Union Trust v. *Heiner decision in spite of its having been followed so often by other courts.* In *Founders* v. *Hoey*, U. S. C. C. A., Second Circuit, July 6, 1936, affirming Judge Goddard's opinion (September 10, 1935), it said:

> "The decision (*Union Trust* v. *Heiner*) therefore proceeded on an indefensible theory."

The Circuit Court opinion in this very case contradicts the reasoning of the District Court, each affirming the judgment on inconsistent grounds. The District Court found herein that "actually there was no sale" (R. 25) and further found "It does not matter that by looking at facts outside the instruments we may perceive that actually there was no sale, but simply a change of brokers" (R. 25). The District Court based its opinion squarely upon the form of the instrument, frankly admitting that there was no sale.

The Circuit Court, on the contrary, likewise supports the tax, although finding by strained and unsound reasoning that *there was a sale*, thus admitting by inference that no tax would levy unless there was a real sale. And the Circuit

Court in the *Uhlmann* case (*supra*) clearly refutes the reasoning that a real sale resulted.

Such a genuine doubt in the minds of eminent jurists is alone sufficient to warrant a determination in favor of the taxpayer.

C. WHERE THERE IS A REAL TRANSACTION SUCH AS IS CONTEMPLATED BY THE TAXING STATUTE, FORM GENERALLY DETERMINES THE DOCUMENTARY TAX. BUT WHERE THERE IS NO REAL TAXABLE TRANSACTION, A FORM IS A MERE SIMULACRUM. This is best expressed in *United States* v. *Uhlmann*, *supra:*

> "The same might be said as to the transaction here involved, *if we chose to be governed by the mechanics rather than the purpose of the transfers.* We think, however, that the character of the transaction is not conclusively determined by the nature of the book-keeping entry used in bringing it about. We agree with the finding of the District Court that the transactions herein described were not sales, agreements of sale, or agreements to sell, hence were not properly taxed as such." (Italics ours.)

In *Merchants Warehouse* v. *McClain*, 112 Fed. 787, aff'd 115 Fed. 295, the Court said:

> "I do not understand, however, from either of these cases that the instrument is to be entirely divorced from the circumstances under which it is given; and indeed, I do not well see how it could be, since *we must to some extent, look to the connection, to know just what it is with which we are dealing.*" (Italics ours.)

To the same effect, see *Union Trust Co.* v. *Heiner*, 26 F. (2d) 391; *Dean* v. *Caldwell*, 9 F. Supp. 177; *Field Glore* v. *United States* (Standard Fed. Tax Service, Vol. 3-A, 1935, pp. 9803-9805); *A. B. Leach* v. *United States*, 84 F. (2d) 908; *National Bond & Share Corp.* v. *Hoey*, D. C., S. D. N. Y., November 6, 1935, and April 15, 1936.

Union Trust Co. v. *Heiner* has been cited with approval in several decisions since.

In *National Bond & Share Corp.* v. *Hoey*, D. C., S. D. N. Y., Judges Julian W. Mack and Robert Patterson, in the same district, disagreed with, and declined to follow, a previous decision by Judge Goddard finding that form alone controls. The tax being construed was the same as in the case at bar, Revenue Act of 1926, Title 8. The facts are identical in that the National Bond & Share Corporation was the owner of securities which were transferred from its brokers to the Guaranty Trust Company, also acting as broker. There was no change of ownership. There was no sale. There was merely a transfer of brokers or agents. The Government, recognizing there was purely a question of law involved, tested it out on a motion to dismiss the complaint on the authority of Judge Goddard's District Court opinion in *Founders* v. *Hoey* (September 10, 1935). Judge Mack (November 6, 1935) declined to follow Judge Goddard and ruled in accordance with the five other Judges in the foregoing cases that there was proper ground for a tax refund. Subsequently Judge Patterson granted summary judgment in favor of the taxpayer (April 15, 1936). Judge Goddard apparently is the only Judge in the United States who has ever held that a transfer of brokers without a transfer of title is taxable under these schedules (*Founders* v. *Hoey*, *supra*, and the *case at bar*). He rests his opinions in each case upon a single isolated phrase picked out of the case of *United States* v. *Isham*, a decision sixty years old, decided prior to the origin of these conflicts. He disregards the two cardinal principles laid down in that decision to the effect that doubts should be resolved in favor of the taxpayer, and that the words of the statute are interpreted by the understanding of that public in which they are to take effect. He likewise overlooked or disregards the decisions of Judges Schoonmaker, Gore, Barnes, Holly and Mack, who all held that a transfer of brokers is not a taxable transaction contemplated by the statute.

Though there was no sale, a tax was levied because a form was used for the convenience of bookkeeping and record. The form is the instrumentality through which a *real* sale is taxed. Stamps are required only on documents used in

connection with transactions contemplated by the taxing statute. Though a document be of a form customarily used in a taxable transaction, *if, in truth, it was erroneously or unwisely used in connection with a non-taxable transaction,* no tax is assessable. The document is only the means through which Congress reaches the *real transaction.* Where there is no taxable transaction, the empty form ceases to be important.

POINT III.

A transferred sale is exempted by the statute.

The statute expressly exempts "transferred or scratch sales." The record describes a transferred sale as a transfer of a contract from broker to broker without commission being charged (R. 22). Treasury Regulation 71, Articles 4A and 125(3)(c), describe it as a purchase and sale at the same session of the Exchange, at the same price, and on the same day, for the account of the same person. Here the purchase and sale were made by Fenner & Beane and DuPont on the same Exchange, on the same day, at the same price, and for the account of the same customer, Abney.

The Court was unwarranted in rejecting the testimony of all the witnesses in this respect by merely calling them "opinions." The "opinions" of qualified experts must be relied upon by the Court where they are given honestly and in good faith, when the Court has no knowledge of its own on the subject.

It is a rule of construction that where technical words are used, the testimony of experts in that industry determines the meaning of the words. *United States* v. *Isham*, 17 Wall. 496, is authority for this point also:

> "The words of the statute are to be taken in the sense in which they will be understood by that *public in which they are to take effect.* Science and skill are not required in their interpretation, *except where scientific or technical terms are used.*"

The testimony in the record is uncontradicted—a transferred sale is described (R. 22) as a transfer from broker to broker for the account of the same customer without any transfer of title, and no commission can be charged where the transfer is requested by the broker, as in this case. The Cotton Exchange defines a transfer in its by-laws (R. 22): "* * * a transfer of contracts already outstanding for the account of a customer * * *." The secretary of the Clearing Association distinguished a transferred sale from a regular sale (R. 11). The secretary of the Cotton Exchange refers to it as:

> "Simply a transfer of outstanding contracts from the carrying to the receiving broker and the customer is not penalized by the payment of a commission or revenue tax. If an actual change of ownership took place, the house carrying the contracts would not be permitted to waive its commission" (R. 10).

We all are bound by this testimony. Who better knows the meaning of technical language in this business than the secretaries of the Exchange and of the Clearing Association, respectively occupying their positions over seventeen years, and thoroughly familiar with the language of the business, corroborated as they are by the language of the by-laws?

CONCLUSIONS.

The judgments should be reversed and judgment granted to the plaintiffs with costs and disbursements in all courts.

Respectfully submitted,

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I. MAURICE WORMSER,
Attorneys for Plaintiffs-Appellants.

Testimony of one Winston before the House of Representatives (referred to by Government counsel below) is not part of this record, was not subject to cross-examination in this case, is not binding on the parties hereto, *is incorrect*, and it is improper to refer to it.

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Supreme Court of the United States

OCTOBER TERM, 1936.

FRANCIS I. DUPONT, EDMUND DUPONT, RHETT DUPONT, E. PAUL DUPONT, WILLIAM A. FINE, ARTHUR F. SHETTLE and WILLIAM A. WHITAKER, co-partners, trading under the firm name and style of FRANCIS I. DUPONT & COMPANY, Plaintiffs-Appellants,

against

UNITED STATES OF AMERICA, Defendant-Respondent.

No. 332.

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS.

This brief answers some of the points raised by the Government's brief regarding: (A) The nature of a transferred sale; (B) the nature of the transaction at bar, and (C) the law applicable.

A.

That the transfer was requested by the plaintiff, in the first instance, is *uncontradictedly shown* in Collins' affidavit (R. 10), and also by the fact that *no commission was charged* (R. 8). Under Exchange Rule 7 (R. 22) a commission otherwise must have been charged.

The Government argues (Br. 17) that this transaction is a sale *under the rules or usages* of the Exchange, because it is expressly provided for by Section 7 of the Rules of the

Exchange (R. 22). *The very section relied upon by the Government defines a "Transfer of Contracts," and not a sale.*

Treasury Regulation Article 125 (3) (c) defines a "pass-out" as only one type of transaction included within the generic term "transfer sale." Article 44 defines the conditions determining the entire generic exempt class of "transfer sales," i. e., "at the same Exchange, on the same day, at the same price, and for the account of the same person." This fits the present transaction perfectly. Winston's testimony before the House (Gov. Br. 14) defined "pass-outs" regulated by Article 125—only one type of "transfer sale" (surely there is at least as much merit in exempting Abney from the burden of *double* taxation as there is in exempting a scalper who admittedly makes two sales and purchases, offsets both, and pays no tax at all on two *bona fide* sales).

B.

The Government repudiates the reasoning of the District Court in this case (Br. 5, footnote) and of the Circuit Court of Appeals, Seventh Circuit, in the *Uhlmann* case (Br. 4, 18), and instead indulges in a tortuous rationalization of the transaction (Br. 7-13) based on erroneous premises unsupported by the record.

(1) The Government, going outside of the record, assumes what "took place" (Br. 9, 10, 11), indulging in a fiction supported neither by the record nor the facts. The Exchange *does not* deliver cotton, nor do we pay the Exchange on delivery. That is all done between the brokers. Furthermore, there are two forms of customers' confirmance notes. Some read "Sold to" the customer, establishing a sale relationship; others read "Sold for your account," establishing an agency relationship. We always used the latter form.

(2) DuPont did *not* sell 24,000 bales *to the Exchange* on March 23, 1934, and Fenner and Beane did *not* buy the same

quantity *from the Exchange* on the same day. They transferred between themselves by office memoranda, not by buying or selling on the floor of the Exchange, and at a price not then prevailing on the Exchange. The transfer price (original cost) varied from the current market price by $25,000.

(3) Under the *usages of the Exchange* what was done was not a "sale," but, under those very usages, it was a "transfer of contracts" under Rule 7 (R. 22).

(4) We do not argue that the transaction was "a mere formality," as the Government states (Br. 11). It was a *bona fide* "transfer of contract."

(5) The footnote on Government Brief (p. 11) is an error. No commission could be charged, and no commission was charged. See Exchange Rule 7 (R. 22) and affidavit of Kohlmann (R. 10).

(6) The Clearing House position with reference to the parties could be, and in fact was, adjusted without the tortuous sales scheme suggested by the Government (Br. 12) and *the statute itself provides exemption from taxation* (see Government Br. 12, footnote 10) "provided that such transfer shall not vest any beneficial interest in such clearing house association but shall be made for the sole purpose of enabling such clearing house association to adjust and balance the accounts of the members of such clearing house association on their several contracts."

C.

The argument *re* administrative interpretation for twenty-six years might perhaps be valid if applicable. *But this type of transaction has never before come up for administrative (or judicial) interpretation.* The absence from the Government brief of citations of administrative rulings thereon is significant proof that the question is *sui generis.*

Provost v. *United States*, 269 U. S. 443, bears no analogy to this case. Loans and returns for short sale deliveries are not simultaneous, are not transfers of existing contracts, and do not involve one and only one principal. Furthermore, that decision was based solely upon the precise wording of the statute involved (War Revenue Acts of 1917 and 1918). The Court distinguished it from other apparently similar acts (at p. 457):

> "Neither of these acts contains the words 'or transfers of legal title to shares or certificates,' which, we have indicated, are of significance in the Acts of 1917 and 1918 because precisely applicable to the transfers under consideration."

Respectfully submitted,

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